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New IRS Code Section 45S - Employer Credit for Paid Family and Medical Leave

The Tax Cuts and Jobs Act, which was signed into law in December 2017, added Section 45S to the Internal Revenue Code of 1986, as amended (Code). Under the new Code provision, an employer that voluntarily offers paid family and medical leave to its employees may be entitled to a tax credit for 2018 and 2019.

The amount of the credit varies depending on the benefit provided by employers. Specifically, the credit equals 12.5% of the wages paid by employers who provide 50% of normal wages during periods of family and medical leave. The credit increases as the employer offers more generous leave benefits, with a maximum credit equal to 25% of wages if the employer provides 100% of normal wages while employees are on leave. Up to 12 weeks of leave per employee per year may be taken into account in calculating the credit. An employer may choose to take the credit in lieu of a deduction for amounts paid during periods of qualifying paid leave (but may not take a credit and a deduction for the same amounts).

To qualify for the credit, the employer's leave program must satisfy certain requirements. Specifically, it must:

- Be in writing;
- Permit all qualifying full-time employees to take at least two weeks of annual paid family and medical leave (and allow part-timers to take a commensurate amount of leave, determined on a pro rata basis); and
- Provide for benefits during the period of leave equal to at least 50% of normal wages.

For purposes of Code Section 45S, "family and medical leave" is defined as leave for any of the following reasons (the same as those under the federal Family and Medical Leave Act (FMLA)):

- Because of the birth of the employee's son or daughter and in order to care for such child;
- Because of the placement of a son or daughter with the employee for adoption or foster care;
- In order for the employee to care for his or her spouse, child or parent because of such individual's serious health condition;
- Because of a serious health condition that makes the employee unable to perform the functions of his or her position;
- Because of any qualifying exigency arising out of the fact that the employee's spouse, child or parent is on covered active duty (or has been notified of an impending call or order to covered active duty) in the armed forces; or
- In order for the employee to care for a covered service member (if the employee is the spouse, child, parent or next of kin of the service member).

If the employer provides paid leave as vacation leave, personal leave, or medical or sick leave (other than leave for one or more of the purposes described immediately above), that paid leave is not considered family and medical leave.

Qualifying employees are those who have been employed for at least one year and whose compensation in the previous year did not exceed 60% of the income threshold used to determine who is a highly-compensated employee for purposes of the qualified plan nondiscrimination rules. Accordingly, for 2018, qualifying employees are those who earned less than $72,000 (60% of $120,000) in 2017.

The "employer" for purposes of Code Section 45S is determined on a controlled group basis. Accordingly, it is unclear how to calculate the credit where members of the same controlled group maintain paid family and medical leave policies offering different benefits (or no benefits) to their employees. For example, suppose Employers A and B are members of the same controlled group. Employer A offers all of its employees four weeks of family and medical leave and pays 50% of normal wages during such leave. Employer B offers a more generous policy, providing for up to 12 weeks of leave with 100% of normal wages. Although all employees in the controlled group are covered by a program satisfying the requirements of Code Section 45S, it is unclear whether the tax credit with respect to benefits paid by Employer B must be reduced in light of Employer A's more limited program. Moreover, if Employer A discontinues its leave policy, it is unclear how that would impact Employer B's ability to take a credit under Code Section 45S.

Several states, including ***New Jersey*** and ***New York***, have adopted laws requiring employers to provide certain levels of paid family leave. Paid family leave has been available since 2009 in New Jersey, where eligible employees are entitled to take up to six weeks of leave annually with a benefit equal to two-thirds of average weekly wages (up to a maximum of $637 per week in 2018), paid by the State of New Jersey and funded through a payroll tax for such purpose. New York's Paid Family Leave Law (NYPFLL), which went into effect January 1, 2018, requires employers to provide eligible employees with up to eight weeks of job-protected leave at 50% of their average weekly wage (up to 50% of the State average weekly wage) for family leave taken in 2018. NYPFLL benefits are paid through insurance, by the employer under a self-funded plan or by the State. NYPFLL benefits are typically funded through employees' payroll deductions. (See our advisory, "What Employers Need to Know About New York's New Paid Family Leave Law," for more details on NYPFLL.) Code Section 45S does not take into account any paid leave required by state or local law in determining the amount of paid leave the employer provides. However, guidance is needed on whether, and to what extent, an employer that pays benefits in excess of State or local requirements may qualify for the credit.

Although guidance on the new tax credit has not yet been issued, Code Section 45S is listed on the 2017-2018 Priority Guidance Plan released by the Treasury Department's Office of Tax Policy and IRS on February 7, 2018. While awaiting guidance, employers interested in the credit should begin reviewing their leave policies to determine whether modifications may be necessary to satisfy the requirements of Code Section 45S.

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